Public Company Series

Board Structure and Composition

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Essential strategies for positioning directors in today's environment

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The role of a public company's board of directors is straightforward in premise: to make informed and prudent decisions on behalf of shareholders. In practice, executing this duty is extremely complex, requiring directors to constantly balance risk and reward while navigating the fine line between supporting the management team and overseeing its actions. In today's era of universal proxy, where directors are voted on by shareholders individually rather than as a single group, the challenge has only intensified.

Public company directors are now effectively treated as political candidates running for office, and shareholders want to know why they should support them. Each director today will face heightened scrutiny of their skills, experience, and ongoing performance every year, even if they are "running" unopposed. Especially in a proxy fight, where incumbents go head-to-head against individual activist nominees, each candidate's value to the board comes under the microscope. If that value has not been clearly demonstrated, the director becomes vulnerable to replacement and reputational damage, which could contribute to the loss of the overall proxy fight.

Compounding this pressure on board members to regularly demonstrate their value is rising demand from institutional investors, proxy advisors, and index funds for direct engagement with board members. With an increasing focus on governance issues, such as board refreshment, tenure limits, and compensation, as well as overall culture issues including broader environmental and social risks, these institutions expect individual board members not only to respond to their concerns, but also to shape their practices in these areas around investor needs.

As a result, the role of the modern board has fundamentally transformed. In addition to the primary goal of building value for shareholders, directors must now be prepared to articulate the rationale behind their decisions and the merit each fellow board member brought to the deliberations. Moreover, they must create a two-way flow of information with shareholders, and build more transparent, strategic, and careful communication into every aspect of their governance.

The importance of this new responsibility cannot be overstated: if a board fails to consistently demonstrate that they actively monitor management, accept and react to feedback from shareholders, and thoughtfully make changes to increase value, they will be replaced.

Board building and refreshment

Critical to success in the current landscape is the idea of board refreshment as an ongoing process. Where refreshment used to be a one-time endeavor to replace a retiring member, shareholders now see refreshment as a necessary way to adapt to the changing needs of the company. Boards must therefore adopt the same perspective, evaluating potential directors not just on leadership or industry experience, but on their ability to develop the right strategy and effectively oversee management's execution.

Traditional considerations remain relevant. Each potential director needs strong leadership skills, financial acumen, and strategic vision. Directors should also be practically fit for the role, with a willingness to collaborate with other members, a passion for the company's mission, and the ability to devote their time and effort. However, these skills *alone* are no longer enough. Specific skills that bring clear and direct value to board discussions are what now set a candidate apart. An effective refreshment process must involve assessing what questions the board does not have answers to, or what questions they are not asking, and looking for candidates with relevant experience and expertise to fill those gaps.

For example, a candidate who led a company through a merger or acquisition will have a clear understanding of how to drive organizational change, optimize operations, and quickly pivot business strategy. Thus, they would be an especially valuable addition to the board of an organization preparing for a merger or facing financial pressure. Similarly, an executive from a sector such as healthcare will be familiar with complex regulatory environments and the necessary compliance and risk management measures required in these spaces, making them a qualified seat on any board concerned with regulatory impacts. A public affairs background, international experience, marketing, or a specific technical background are further examples. Ultimately, while any candidate worth their salt will possess standard leadership skills, it is their unique know-how that can deliver demonstrable value to the company, and that should take precedence in the decision-making process.

Equally important is overall board composition. Beyond selecting individuals with a range of competencies, directors need to think about how these individuals will come together in service of the larger needs of the board and company and, by extension, its shareholders. The ideal board will contain diversity across:

- **Experience levels**—it is always helpful to pair experienced board members who have learned from prior leadership with first-time directors who can offer fresh perspectives.
- **Backgrounds**—blending individual directors from the same industry as the current company with those who have a history in other fields helps to balance a specific focus with a bigger picture lens.

- **Roles**—not all directors need to be former chief executive officers. Other C-suite executives, such as chief financial officers or heads of marketing, provide valuable insights that are useful for ensuring the board is prepared for a range of situations.
- **Skillsets**—in addition to relevant experience, every board should also have a few directors with specialty skills in areas like artificial intelligence, cybersecurity, human resources, and so on. These skillsets help directors better anticipate different risks, challenges, and outcomes.
- **Thought**—diversity of thought is perhaps the most important factor in composing a strong board. Including a director who approaches the industry differently, thinks about things from a unique angle, or knows how to ask questions others may not think of brings a necessary point of view that ensures the board is being as detailed and thoughtful as possible.

As representatives of *all* shareholders, boards need to accurately understand and consider the wide range of wants and needs different shareholders will have, while prioritizing their obligation to mitigate risk and increase value overall. A well-constructed board helps ensure that each member's knowledge is put to good use and strengthens the company's ability to articulate its value proposition to shareholders.

Announcing these new board members also comes with its own challenges. In the past, issuing a press release with a quick look at a member's background and a nice quote was all that was necessary. Now, it is not just the result of board refreshment that shareholders want to see, but an inside look at the process. Boards should be careful to demonstrate at least two essential steps in refreshment communications:

1. Identification of a clear board need: refreshment should come from consistent examining and re-examining of board needs over time. If the need that ultimately prompted refreshment directly relates to an element of the company's strategy, or a change in the company's strategy, explain this to shareholders. The more they can connect the dots between refreshment and the value it will deliver to them, the better.
2. Retaining a third-party firm: enlisting support to help source and vet candidates helps to show that the new director is independent. By disclosing a thoughtful process, the board gives themselves and the new candidate increased credibility, allowing them to better serve the company's shareholders.

Committees and their evolving role

The shift in board expectations also extends to committee building. Boards today must actively leverage director skills within their committees to advance the company's objectives. First, though, they need to evaluate what committees are necessary.

Nearly every company will require some combination of the classic committees: Compensation, Nominating and Governance, and Audit/Risk Management. Yet, as with director skills, modern committees benefit from greater specificity. Boards should identify subject areas they need more information on to make prudent decisions, or what issues they anticipate will need further attention from the organization, and craft committees accordingly. Such committees might be human capital–focused, like a People and Safety Committee; industry-specific, like a Technology or Science Committee; or they may concern specific business risk areas such as Regulatory Affairs, Cybersecurity, or Digital Transformation Committees.

Regardless of its focus, all of these committees should follow the same composition principles as the overall board in terms of diversity of experience and rationale for membership. It is essential that no single director becomes the head of every committee. Instead, each committee should be staffed with a blend of experienced committee members and novices, directors with concentrated expertise and general skillsets, and individuals with distinct points of view or ways of thinking. Above all, every committee member selected must have or learn the specific skill of shareholder engagement.

Committees as communicators

Committees have become the primary avenue through which shareholders wish to engage. Specifically, as index funds and the like have gone from holding a small percentage of public company stock to often being the top 3 shareholders over the past 2 decades, they have required members of Compensation, Nominating and Governance and even Audit Committees to engage with them both during and outside of contentious proxy fights. In fact, continued engagement with board members is seen as central to their role as responsible passive fund managers.

The same is true of proxy advisory firms, whose voting recommendations have been followed by an increasing number of institutions in recent years, and whose role and relationship to boards is therefore only growing. While executive management does regularly engage with active shareholders, directors—particularly chairs of the Compensation or Governance committees—have become the primary conduits for conversation.

In this way, committee members have essentially become the direct ambassadors to at least 20%–40% of the shareholder vote annually. Therefore, to be successful in their role as committee chair or member, a director must be able to distill and convey key discussions, decision-making processes, and strategic visions to shareholders. They will also need to ask investors questions, be open-minded to their feedback, and incorporate it clearly into future plans.

Their ability to do so has *significant* tangible impacts, as investors tend to use these meetings to gain perspective into how well the board is functioning. If management dominates the conversation or the board's answers seem perfunctory or scripted, investors will speculate as to whether the board is performing its oversight duty. Further, a board that communicates poorly can be perceived as lacking empathy, honesty, or competence, which can have dire consequences for shareholder relations.

On the contrary, when these meetings go well, directors gain credibility with shareholders, helping them garner support that could prove critical in the future. Take for example a scenario where a company's strategy is to improve financials, but an activist targets the company after stock performance has lagged. The credibility built up through careful committee engagements and thoughtful investor materials could be the deciding factor in the vote. With this in mind, every public company should consider investing in training their board members in areas such as public speaking, crisis management, and media relations to maintain a favorable relationship with shareholders. It may also be worth investing in ongoing education and training programs for board members to help them stay ahead of technology and other evolving trends that will affect their ability to make informed decisions on a wide range of potential issues the company and the public may take an interest in.

Board advocacy and the power of transparency

Thoughtful board refreshment and committee-building strategies offer clear benefits to any company. Yet, their greatest potential lies in how they could affect the shareholder–board relationship, which means they must be showcased publicly. When shareholders can clearly see a fit-for-purpose board—a panel of experts whose experiences are directly related to the company's strategy—they are more likely to trust the board's ability to guide the company in the right direction. Further, they will better recognize individual board members and connect their unique expertise to the issues they care about, ensuring they know who to support and engage in critical moments.

Board advocacy is key to achieving these goals. Just as a political candidate needs the strength of a party behind them, a board needs support from the company. It is the company's responsibility to ensure shareholders are made aware of director value explicitly and regularly, beginning by shifting all board communications away from the "who" and toward the "why." Instead of merely presenting a board member alongside a bio that summarizes their curriculum vitae, companies need to outline what each director offers to the board and *why* they are an asset to the organization. A clear connection between relevant resume points and the company's industry or strategy should be drawn, and details on the member's contributions to board efforts, such as their role in steering critical initiatives or tackling challenges, must be highlighted.

Critically, this cannot be a one-time effort and should instead be visible to all stakeholders, from shareholders to customers and employees, everywhere they may encounter the brand. Examples might include:

- annual general meetings;
- proxy statements and annual reports;
- investor relations meetings;
- press releases and public relations;
- company website;
- industry events;
- social media;
- internal and employee communications; and/or
- partnership announcements.

While advocacy may seem a lower priority relative to all other board duties, the importance of a consistent board advocacy message platform has only grown in the context of universal proxy. It is simply easier than ever to challenge boards, and the challenge will now be aimed at specific board members. Highlighting the contributions of individual board members is difficult due to the non-public nature of much of their activity, making it necessary to use the communications platforms available to connect the company's progress on its strategy to the backgrounds and experience of their board. This is foundational to building and maintaining confidence in the board's ability to meet changing and increasingly complex shareholder expectations. It also facilitates the building of critical relationships with proxy advisors and institutional investors. Simply put, it enhances the board's reputation—through good times and bad times—and positions each member for long-term success.

Advocacy is particularly crucial in times of crisis and shareholder activism. Strong advocacy will reduce the likelihood of activism by consistently demonstrating to investors that the board has the right skills and processes in place to monitor management and make informed and sound decisions. Still, when activist situations do arise, advocacy helps to ensure shareholders are well aware of the value current directors bring to the table and bolsters their support. Members themselves benefit too, as advocacy prepares them to showcase their skill, relate to shareholders, and articulate the board's work effectively.

Similarly, there are several other stakeholders whose perceptions of the board and company at large can be shaped through advocacy. Employees, customers, and the community should see regular communications around board activities that help them understand how the company is reacting to social and political changes and acting responsibly and inclusively. In this way, the board can help secure a more favorable position for the company in the public consciousness that can affect the company's success and longevity.

Essentially, boards must understand that every aspect of what it means to build and operate a board has been reshaped. In the era of universal proxy and ever-greater interconnectivity, transparency and adaptability are not just buzzwords; they are the pillars that enhance board effectiveness and fortify shareholder confidence. Much like politicians who must continuously engage with their constituents, board members must actively communicate with their stakeholders, demonstrating their value and responsiveness to concerns.

As board members adapt to these principles becoming the norm, and the shape of their role continues to evolve, one thing is certain: building out communications skills, and integrating communication considerations into every decision-making process, is not a negotiable aspect of governance but a vital component of a successful and resilient public company.

By preparing for and embracing these changes, boards can not only meet the demands of today's shareholders but also anticipate and adapt to the future challenges of the stakeholder economy.

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